

Internal Revenue Service

Department of the Treasury

NO POSTAL RECEIVED  
Release copies to District

Washington, DC 20224

Date 05/28/97

Surname [REDACTED]

Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to: [REDACTED]

Date: JAN 15 1997

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption as an organization described in section 501(c)(3) of the Internal Revenue Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section.

FACTS

You were formed on May 25, 1995, pursuant to the laws of [REDACTED]. You submitted your application under section 501(c)(3) of the Internal Revenue Code on January 23, 1996. You also requested status as other than a private foundation under section 509(a)(2).

You were formed by [REDACTED]

As provided in your Bylaws these two entities are classified as Founding Members. Each Founding Member appoints a member to your Board of Directors. The other members are classified as Employer Members. At this time you have one Employer Member. The Employer Members must be corporations, limited liability companies, registered limited liability partnerships, partnerships, limited partnerships, proprietary, or some other such entities regularly conducting business, and having employees. The Employer Members elect the other Board members. At this time your Board of Directors has three members.

You have represented that your activities include:

1. Community Based Reform - encompasses a sense of responsibility that employers and health service providers should work in tandem to improve the health of the community. You routinely work with providers on issues while actively seeking solutions. This activity promotes continuous quality improvement and assessment. Customer and patient satisfaction is examined regularly

with the physicians' association. Various types of clinical screenings and evaluations may be incorporated.

2. Quality Initiatives - your members want to create an environment where health care providers compete on cost and quality. Quality care will become more objective and quantifiable as clinical pathways and guidelines are established. Quality initiatives are ongoing activities, particularly with medical providers.
3. Consulting Members - you provide a forum for employers (payors) to share cost-containment experiences and strategies. The coalition consults member employers on contemporary issues addressing the delivery and financing of health services. The consulting and educational activities are ongoing functions which are performed by your President and Board. This function also facilitates discussion with health service providers.
4. Group Purchasing - You make group purchases of health care services for your members. This includes both physician services and hospital services. You do not charge a fee for these services in particular. These are some of the services that you provide to your members. This activity is directed by your President.

Your sources of financial support are dues from member organizations and grants.

#### ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations which are organized and operated exclusively for charitable or educational purposes, no part of the net income of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purposes.

Section 1.501(a)-1(c) of the regulations provides that private shareholders or individuals are defined as persons having a personal and private interest in the activities of an organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of section 501(c)(3) of the Code, it is necessary for you to establish that you are not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

The private benefit prohibition of section 501(c)(3) applies to all kinds of persons and groups, not just to those "insiders" subject to the more strict inurement proscription. Prohibited private benefit may include an "advantage; profit; fruit; privilege; gain or interest." Retired Teachers Legal Defense Fund v. Commissioner, 78 T.C. 280, 286 (1982).

An organization may provide benefits to private individuals provided those benefits are incidental quantitatively and qualitatively. To be qualitatively incidental, private benefit must be a necessary concomitant of an activity that benefits the public at large; in other words, the benefit to the public cannot be achieved without necessarily benefitting certain private individuals. To be quantitatively incidental, the private benefit must be insubstantial, measured in the context of the overall public benefit conferred by the activity. To illustrate the quantitatively incidental concept, compare Rev. Rul. 68-14, 1968-1 C.B. 243, with Rev. Rul. 75-286, 1975-2 C.B. 210. In Rev. Rul. 68-14, an organization that helped beautify a city was exempt when it planted trees in public areas, cooperated with municipal authorities in tree plantings and programs to keep the city clean, and educated the public in advantages of tree planting. In Rev. Rul. 75-286, an organization with similar activities did not qualify under section 501(c)(3) where its members consisted of residents and business operators of a city block and its activities were limited to that block. The facts in Rev. Rul. 75-286 indicate that the organization was organized and operated for the benefit of private interests by enhancing the value of members' property.

The facts submitted indicate that you are merely negotiating health care benefits for your members and their employees. You also carry on educational activities mostly for the benefit of your members and their employees. These two activities are not charitable or educational activities under section 501(c)(3) of the

Code because they serve the private interests of your employer-members in conducting their private businesses.

Your employer-members are "private individuals" and are subject to the private benefit proscription. The employer-members receive the benefit of reduced costs in providing health care benefits to their employees. The substantial private benefit to the employer-members is fatal to your exempt status. Furthermore, since the employer-members have representation on your Board of Directors, the employer-members on your Board are "insiders" subject to the inurement proscription. Therefore, receipt of private benefit by these Board members also violates the statutory prohibition against private inurement.

Based on all the facts and circumstances, the Service must conclude that you are not primarily engaged in charitable or educational activities, and that you benefit more than insubstantially the private interests of your employer-members, some of whom also receive prohibited inurement. You are therefore operated for a substantial nonexempt purpose. See Better Business Bureau v. United States, 326 United States 278 (1945).

For the reasons stated above, we have concluded that you do not qualify for exemption from federal income tax under section 501(c)(3) of the Code and you are required to file federal income tax returns. Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the United States Court of Federal Court, or the District Court of the United States for the District of Columbia determines that the organization involved has

exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director. Thereafter, if you have any questions about your federal income tax status, including questions concerning reporting requirements, please contact your key District Director.

Sincerely yours,

Chief, Exempt Organizations  
Technical Branch 1

cc:

Cc:

	:	Initiator	:	Reviewer	:	Reviewer	:	Reviewer
Code	:		:		:		:	
Surname	:		:		:		:	
Date	:	01-14-97	:	<i>[Signature]</i>	:		:	

*1/15/97*